

Introduction of behavioural responses to EUROMOD: an application to the Austrian family tax credit

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Abstract:

We introduce behavioural responses to the static EUROMOD microsimulation model by allowing households to adapt their labour supply in reaction to changes in the tax transfer system. Labour supply choices of households are estimated with a structural discrete choice model based on the concept of random utility maximization, where households choose from a discrete set of alternatives of income leisure combinations such that their utility is maximized. The estimated labour supply elasticities are low in particular for men, larger responses are estimated for married women in particular along the extensive margin. In a further step this newly developed tool is applied to estimate the distributional and fiscal effect of a newly introduced family tax credit in Austria by taking labour supply responses into account. We find that compared to a static model without behavioural responses the effect on inequality is lower as in particular low income households increase their labour supply. Also the fiscal cost of the reform is slightly lower due to additional tax revenues resulting from the overall increase in labour supply.